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NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

TEXAS EXTRUSION CORPORATION, PICKENS INDUSTRIES, INC., RICHARD W. PICKENS and LOUISE R. PICKENS,
Petitioners,

v.

LOCKHEED CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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September 6, 1988

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QUESTIONS PRESENTED

1. Does a disclosure statement which fails to provide a complete and accurate description and evaluation of lawsuits which are the debtors' largest assets and defenses to the debtors' largest claims, and fails to state directly the primary choice presented to the creditors, satisfy the "adequate information" standard of 11 U.S.C. § 1125?

2. Does a bankruptcy court have the statutory and constitutional power to enter a final, dispositive order of dismissal, and make fact findings, concerning lawsuits involving breach of contract and fraud claims, as part of "proceedings in respect to confirmation of plans"?

3. Do Bankruptcy Rule 9003, DR 7-110(B) of the Code of Professional Responsibility, and Canon 3A(4) of the Code of Judicial Conduct, prohibit repeated and extended *ex parte* discussions between the bankruptcy judge and counsel for the winning party in a contested matter, where counsel and the judge prepare and discuss four amended versions of written findings of fact and conclusions of law?

LIST OF PARTIES

The parties to the proceedings below were:

Petitioners

Texas Extrusion Corporation

Pickens Industries, Inc. (holder of 100% of stock of Texas Extrusion Corporation)

Richard W. Pickens and Louise R. Pickens, husband and wife (owners of 80% of stock of Pickens Industries, Inc.)

Affiliates

Texas B&P Machine Co., Inc.

Texas Extrusion Presses, Inc.

Respondent

Lockheed Corporation

Affiliate

Lockheed Finance Corp.

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v.

LOCKHEED CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioners, Texas Extrusion Corporation, Pickens Industries, Inc., Richard W. Pickens and Louise R. Pickens respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on May 12, 1988.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported at 844 F.2d 1142, and is reprinted in the appendix hereto, p. 1a *infra*.

The memorandum decision of the United States District Court for the Northern District of Texas (Porter, D.J.) is reported at 68 B.R. 712.

JURISDICTION

Invoking federal jurisdiction under 28 U.S.C. § 1471, petitioner Texas Extrusion Corp. ("Texas Extrusion") brought suit against respondent Lockheed Corp. and its subsidiary Lockheed Finance Corp. (collectively "Lockheed") in the Bankruptcy Court for the Northern District of Texas, Dallas Division ("the corporate suit"). Later, invoking federal jurisdiction under 28 U.S.C. § 1332, petitioners Richard W. Pickens and Louise R. Pickens ("Pickens" or "the Pickens") brought suit against Lockheed in the Northern District of Texas, Dallas Division ("the individual suit"). Petitions for relief under Chapter 11 of the Bankruptcy Act were filed for all four petitioners in the Bankruptcy Court for the Northern District of Texas.

Following entry by the Bankruptcy Court of an order confirming a plan of reorganization, petitioners perfected their appeals to the District Court pursuant to 28 U.S.C. § 1334. The District Court affirmed, and petitioners perfected their appeal to the Fifth Circuit, pursuant to 28 U.S.C. § 1291. Certain final orders, including an order of dismissal of the individual suit, entered by the District Court in connection with the plan of reorganization, were

appealed directly to the Fifth Circuit pursuant to 28 U.S.C. § 1291.

On petitioners' appeals, the Fifth Circuit on May 12, 1988, rendered its judgment and opinion affirming the Bankruptcy Court. Thereafter, petitioners timely filed a petition for rehearing, which was denied on June 7, 1988.

The jurisdiction of this Court to review the judgment of the Fifth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statutes involved in this petition are 11 U.S.C. § 1125, the Emergency Interim Rule (Local Rule of the Northern District of Texas Concerning Bankruptcy Cases and Proceedings),[1] Art. III § 1 of the United States Constitution, and Bankruptcy Rule 9003. Each of these statutes is reprinted in the appendix hereto.

STATEMENT OF THE CASE

The controversy which is at the heart of this appeal is based upon dealings between petitioners Richard Pickens and Texas Extrusion with respondent Lockheed Corporation beginning in late 1978. At that time, Lockheed approached Pickens, and asked that Texas Extrusion expand its aluminum extrusion plant, and convert it to the manufacture of hard alloy aluminum extrusions, because Lockheed was in desperate need of a reliable source of such extrusions for its L-1011 airplane program. Despite Pickens' initial reluctance, Lockheed ultimately convinced Pickens and Texas Extrusion to borrow $5.5

1. Since the relevant portion of the Emergency Interim Rule is in substance identical to 28 U.S.C. § 157(b)(2)(L), an interpretation of the interim rule is also equivalent to an interpretation of the current statute. This statute is also reprinted in the appendix.

million from Lockheed Finance to expand and refurbish the Texas Extrusion facilities, and enter into a 10-year supply contract, based upon written projections of $27 million in profits for Texas Extrusion over the life of the contract. The money was lent, the facilities were expanded, and Texas Extrusion began performing under the supply contract, with Lockheed purchasing virtually all its production, but Lockheed shortly thereafter breached the contract, forcing petitioners into financial difficulties.

During 1981, while Texas Extrusion was in severe financial difficulties due to Lockheed's breach of the supply contract, and was being pressured by Lockheed Finance for payment, Lockheed, through various means of control over the petitioners, forced the execution of an amended supply contract which contained within it a clause purporting to release Lockheed from liability under the original contract. Despite promises of additional business which induced the execution of the 1981 amendment, Lockheed shortly thereafter cancelled the L-1011 program, and breached its obligations under the second contract. When Lockheed again began pressuring petitioners to pay the debt which had been incurred in expanding the plant for Lockheed's benefit, and threatening seizure of the plant and liquidation, Texas Extrusion and its holding company filed petitions for relief under Chapter 11 of the Bankruptcy Act in March 1982. Lockheed was the largest secured creditor in these proceedings.

Immediately after the Chapter 11 proceedings were initiated, the corporate suit was filed as an adversary proceeding against Lockheed and Lockheed Finance for breach of the supply contract, and fraud, seeking $40

million in actual damages, and $80 million in punitive damages. Because of jurisdictional objections raised by Lockheed based upon the decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, (1982) (hereafter *"Marathon"*), the case was promptly thereafter transferred to the District Court for the Northern District of Texas, where the case remained until shortly before the hearing on the plan of reorganization.

Because of claims asserted by Lockheed against the Pickens as guarantors, Richard W. Pickens and Louise R. Pickens each filed petitions for relief under Chapter 11 of the bankruptcy laws in February and November 1983, respectively. In November 1983, the Pickens filed the individual suit against Lockheed, seeking recovery of $15.5 million in damages suffered individually as guarantors arising from Lockheed's breach of contract and fraud.

Beginning in late 1983, Lockheed, along with the unsecured creditors committee of Texas Extrusion, proposed a plan of reorganization which had as its essential feature dismissal of the two lawsuits against Lockheed, and sale of all of the debtors' (petitioners') assets. The petitioners vigorously opposed the plan of reorganization. They retained present counsel of record shortly before the beginning of the confirmation hearing, who immediately sought to have the corporate suit transferred back to the district court, asserting the bankruptcy court's lack of constitutional jurisdiction, and opposed Lockheeds' motion to refer the individual lawsuit to the bankruptcy court on the same grounds. The confirmation hearing began in February 1984 and continued over four days of testimony. Prior to the conclusion of the hearing, petitioners filed a notice of non-consent advising the bank-

ruptcy court that, based upon *Marathon,* they did not consent to his entering a final, dispositive order concerning their lawsuits.

Immediately following the conclusion of the testimony on March 3, 1984, the bankruptcy judge announced his decision to confirm the plan of reorganization, and made lengthy verbal findings of fact not only concerning the plan, but also relating to the underlying factual disputes in both the corporate lawsuit and the individual lawsuit.

Soon after the hearing was concluded, counsel for Lockheed began submitting written findings of fact and conclusions of law to the bankruptcy court, without serving copies on petitioners' counsel. The written findings, and order confirming plan, were signed March 20, 1984.

At the hearing on petitioners' motion to amend findings of fact, it was disclosed that there had been repeated and extensive discussions between counsel for Lockheed and the bankruptcy judge in which four separate versions of the written findings of fact were prepared and discussed. Respondent readily acknowledged that counsel for petitioners was not advised of these communications.

Petitioners duly perfected their appeal from the order confirming plan to the district court, which did not rule until December 30, 1986, at which time the bankruptcy court's orders were affirmed. Although all parties requested oral argument, there was no oral argument granted, and, despite petitioners' constitutional objections, no opportunity was given for *de novo* consideration of evidence. Appeal was then perfected to the Fifth Circuit.

Certain ancillary final orders in connection with the plan of reorganization were appealed directly to the Fifth

Circuit, which were abated, and consolidated with the main appeal from the order confirming plan of reorganization. The Fifth Circuit, in the consolidated proceedings, affirmed the bankruptcy court's order confirming the plan of reorganization. Petitioners' motion for rehearing was denied, and petitioners have duly presented this petition for certiorari to this Honorable Court.

Since Lockheed, the bankruptcy trustee for Texas Extrusion, and the creditors' committee, have stipulated that if the plan is reversed, no attempt will be made to require creditors to repay the dividends they have received, and the creditors will have no further participation, Lockheed is the only party that will be adversely affected by reversal of the courts below.

REASONS FOR GRANTING THE WRIT

I. The Fifth Circuit's Decision Emasculates The "Adequate Information" Requirement of 11 U.S.C. § 1125, Which is Pivotal to the Disclosure Concept of the Bankruptcy Code

A. The "Adequate Information" Standard is Critical to the Bankruptcy Code

The purpose of § 1125 of the United States Bankruptcy Code (11 U.S.C.A. § 1125(a)(1)) is to ensure that creditors voting on a plan of reorganization have "adequate information" to enable them to make an intelligent and informed decision as to whether to accept or reject it. The legislative history to § 1125 emphasized that the key to the statute is the disclosure section, which is based upon the premise of allowing creditors to make an "informed decision". H. R. Rep. No. 595, 95th Cong., 1st Sess. 226 (1977).

Thus, the Bankruptcy Code contemplates that the creditors, not the judge as under the old act, will have the information which will enable them to make an informed decision as to whether or not they will vote for a plan of reorganization. *See* 5 *Collier on Bankruptcy* ¶ 1125.03 (15th ed. 1984).[2] The legislative history concluded that, due to the fundamental changes in the handling of reorganization cases under the Bankruptcy Code, the hearing on the disclosure statement "will be one of, if not the major, procedural hearing in a reorganization case." U.S. Code Cong. & Ad. News, 95th Cong., 2nd Sess., 1978, p. 6186. As the legislative history also indicates, the disclosure statement hearing was to be one of the essential safeguards crucial to the new Bankruptcy Code, in that it would make the judge a "fairer arbiter", and not an advocate of the plan, which in the past "had led to a suspicion of bias on the part of many dealing with the bankruptcy court". *Id.* at 6187-6188.

B. The Disclosure Statement Here Failed to State Clearly the Primary Issue to be Decided and to Give an Evaluation of the Suits Against Lockheed and Defenses to its Claims

At the confirmation hearing, the Bankruptcy Judge correctly noted that "the guts of the thing . . . is what [the corporate lawsuit] is worth". (Confirmation Hearing

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2. The attitude of the Bankruptcy Judge below was pre-Code. At the hearing on the Disclosure Statement, he stated, with respect to litigation, that "there's no use of giving a bunch of information. Just like when you have a settlement in a lawsuit, there's no use in really giving information about that settlement to the creditors. They don't know whether it's a good settlement or not. They haven't been involved in a court hearing and *it's a kind of a silly requirement of the Code to have to do that . . .*" (Hearing on the Disclosure Statement at 65.) (Emphasis added.)

Transcript, hereafter "Conf. Hear." at 913). All parties agreed by their statements and actions.

It would have been simple to place the following legend at the beginning of the disclosure statement so that creditors would have been advised of the central issue to be decided:

> THE CENTRAL ISSUE TO BE DECIDED IN WHETHER TO ACCEPT OR REJECT THE PLAN IS WHETHER OR NOT THE LITIGATION AGAINST LOCKHEED SHOULD BE DISMISSED BECAUSE YOU BELIEVE THAT THE ULTIMATE VALUE TO BE RECOVERED FROM THAT LITIGATION IS LESS THAN THE BENEFIT THAT YOU WILL RECEIVE FROM THIS PLAN OF REORGANIZATION, TAKING INTO CONSIDERATION THE RISKS OF LITIGATION.

Such a conspicuous statement would have allowed a hypothetical reasonable creditor to focus upon the same issue which was the focus of the confirmation hearing. *Nowhere* in the Disclosure Statement is this statement or any similar statement made. After precisely this argument was made by counsel for petitioners (Conf. Hear. at 268-269), the Bankruptcy Court stated, "[W]ell, I admit they didn't emphasize that." (Conf. Hear. at 269). Indeed, the Fifth Circuit in its opinion here frankly acknowledged "that *the importance of the valuation and settlement of the various lawsuits* between appellants and Lockheed to the plan *was not emphasized in the disclosure statement*", and that the creditors were not told the importance of the settlement of the lawsuits to the plan "in so many words". 844 F.2d at 1157, App. at 27a. (Emphasis added).

Likewise, the attorney for the Creditors' Committee had to admit that nowhere in the Disclosure Statement is there any analysis of the value of the lawsuit (Conf. Hear. at 927-928), and the chairman of the committee admitted that a person cannot tell the value of the lawsuit by reading the Disclosure Statement (*Id.* at 281-282).

Most courts have required some *valuation* of a debtor's key assets in disclosure statements so that creditors could make an informed judgment. *In re Feldman,* 53 B.R. 355, 358-359 (Bkr. S.D. N.Y. 1985); *In re East Redley Corp.,* 16 B.R. 429, 430 (Bkr. E.D. Pa. 1982); *In re Ligon,* 50 B.R. 127, 130 (Bkr. M.D. Tenn. 1985); *In re Metrocraft Publishing Services, Inc.,* 39 B.R. 567, 569-571 (Bkr. N.D. Ga. 1984); *In re A.C. Williams Co.,* 25 B.R. 173, 176 (Bkr. N.D. Ohio 1982); *In re New Haven Radio, Inc.,* 18 B.R. 977, 980 (Bkr. D. Conn. 1982); *In re Werth,* 29 B.R. 220, 223-224 (Bkr. D. Colo. 1983). The Fifth Circuit decision in this case is the first circuit court decision construing § 1125 of which petitioners are aware, and it is contrary to this established weight of authority.

By analogy, the type and extent of disclosure which should now be made to the creditors should parallel the considerations which this Court required the judge, under the old act, to make, in *Protective Committee For Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414 (1968). In *Protective Committee,* this Court stated that the bankruptcy judge should

> [apprise] himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting

> on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation.

Id. at 424-425; *see also, id.* at 434. This Court further noted that in the absence of complete disclosure to creditors, "it is scarcely surprising that creditors failed to come forward with objections to the compromises." *Id.* at 435. Under the new disclosure concept envisioned by the Bankruptcy Code, these factors should have been explained to the creditors in the disclosure statement.

Courts interpreting § 1125(a)(1) have quite understandably held that litigation by the debtor against creditors is of primary importance in a disclosure statement. Thus, the court in *In re Malek,* 35 B.R. 443 (Bankr. E.D. Mich. 1983), held that litigation issues

> are to be described in an objective and professional tone, free of any mischaracterizations of the issues to be resolved in such litigation. Where possible, the [proponent] should provide an evaluation of the probable success of any litigation and its effects on the Debtor's business or his plans for reorganization under Chapter 11. . . . *All pending or contemplated litigation of whatever nature must be described fully, completely, and in detail.* Trial dates, where known, must be disclosed. Appeals, filed or contemplated, must be disclosed. *The disclosure statement must include a professional evaluation of the probable success of any pending or contemplated litigation.*

Id. at 444 (emphasis added); *accord, In re Cyr Bros. Meat Packing, Inc.,* 2 B.R. 620, 625 (Bkr. D. Maine 1980).

Here, rather than fully describing Lockheed's obligations to purchase from Texas Extrusion, and the projections of over $27 million in profits for Texas Extrusion which were being exceeded when Lockheed first breached the contract, the Disclosure Statement simply describes the loans by Lockheed Finance to Texas Extrusion and the subsequent default on those loans. The Disclosure Statement omits any mention of Lockheed's necessary part in insuring Texas Extrusion's inability to repay the Lockheed Finance loans, although its central role in TEC's financial crisis is confirmed not only by Pickens' testimony (Conf. Hear. at 988-989), but also by Lockheed's own internal memoranda (Conf. Hear. Ex. Vol. III, Debtors' Exhibit 9), and by the Bankruptcy Judge's verbal findings. (App. 96a-102a).

The Disclosure Statement only briefly mentions the Texas Extrusion lawsuit against Lockheed and Lockheed Finance. This description is limited to half a paragraph on page 7. (App. 124a). It states that an "adversary proceeding against Lockheed Corporation and LFC seeks $40 million in actual damages and $80 million in punitive damages. Texas Extrusion alleged that Lockheed induced Texas Extrusion to enter into the original Supply Contract by falsely overstating its production requirements. . . ."

In addition to the brief reference to the lawsuits on page 7 of the Lockheed Disclosure Statement, there is a section entitled "Lawsuits and Release" on page 27. (App. 141a). This describes the requirement of the Plan that Lockheed have releases from all four debtors, and includes a paragraph explaining that "[i]t is possible that if Texas Extrusion obtained a judgment against Lockheed in the Texas Extrusion Lawsuit, the unsecured creditors of Texas Extrusion could be paid in full. The

amount of that judgment, however, would have to exceed the entire claim of Lockheed (approximately $7,983,-065.83 plus daily accruals of interest) before any sums would be available for the administrative, tax and unsecured claims in the Texas Extrusion Case."

This manner of describing the lawsuits gives a typical reasonable investor the impression that the lawsuit is relatively insignificant in deciding whether to vote for or against the Plan. It is further misleading because it assumes the validity of the Lockheed claim, and fails to disclose and evaluate the debtors' defenses, including equitable subordination and lendor control. Section 510(c) of the Bankruptcy Code, (11 U.S.C.A. § 510(c) (West 1979)), codified existing law permitting a bankruptcy court to subordinate the claims of creditors under the principles of equitable subordination, to the extent necessary to offset injury to other creditors. *Beniamin v. Diamond,* 563 F.2d 692, 698-701 (5th Cir. 1977).

A court may equitably subordinate a secured claim *even if* it finds the claim to be valid and *even if* a judgment had been previously entered on the claim, as long as the court determines that the creditor has engaged in the requisite inequitable conduct. *See Pepper v. Litton,* 308 U.S. 295, 305-306 (1939) (claim reduced to judgment held subject to equitable subordination). When a claim to be subordinated is secured by a lien, § 510(c)(2) allows the lien to be transferred to the debtor's estate pursuant to 11 U.S.C.A. § 541(a)(4) (West 1979). *See e.g. Zoltanski v. Brown,* 33 B.R. 219 (Bkr. N.D. Ohio 1983) (recovered property becomes property of debtor's estate).

Since equitable subordination can so radically change the ordinary bankruptcy priorities, courts have recognized

that information regarding the possibility of its application is of major significance to a creditor deciding whether to vote to confirm a plan. In *Cyr Bros.*, 2 B.R. at 627, the district court noted that the creditors could not possibly evaluate the merits of the plan without being aware that their unsecured debts might receive a higher priority if certain secured claims were subordinated. *Id. See also Protective Committee,* 390 U.S. at 428 (Court disapproved plan of reorganization because, *inter alia,* facts regarding possible subordination of debts were not in record); *In re Civitella,* 15 B.R. 206, 207 (Bkr. E.D. Pa. 1981) (creditors cannot make independent evaluation of plan if disclosure statement does not contain adequate information regarding classification of debts).

Lockheed was an insider of Texas Extrusion, and as such it had a fiduciary duty to Texas Extrusion which enhances the likelihood of equitable subordination. *See* 11 U.S.C.A. § 101(25); *Wilson v. Huffman,* 712 F.2d 206, 210 (5th Cir. 1983). The evidence at the hearing was that Lockheed determined the debtor's line of business, products and product mix, demanded to be the sole purchaser of its products, and then, after Lockheed breached its contract and precipitated the debtor's serious financial problems, Lockheed's personnel moved in and told Texas Extrusion how to manage its business, and exactly where and how to sell its products. (Conf. Hear. at 999-1002 and Conf. Hear. Ex. Vol. IV, Debtors' Ex. 16, pp. 6-12). These facts closely parallel those in *In re American Lumber Co.,* 7 B.R. 519, 529 (Bkr. D. Minn. 1979).

The facts in this case have an uncanny resemblance to the facts in *Gannett Co. v. Larry,* 221 F.2d 269 (2d Cir. 1955). There, Gannett, wanting to assure a continuous supply of newsprint, financed Berwin, a small

paper manufacturing plant, as its emergency source of newsprint. After Gannett lent a substantial amount of money to Berwin for its expansion, the anticipated shortage never materialized and Gannett failed to purchase sufficient products to enable Berwin to stay in business. When Gannett filed its claims in Berwin's subsequent bankruptcy, the Second Circuit equitably subordinated Gannett's claims and held that "[i]t would be unfair to allow the claim of Gannett on a parity with other creditors who lacked the interest which Gannett had in Berwin's disastrous experiment in the newsprint field." *Id.* at 275.

C. Review is Essential to Provide Proper Guidance to the Bankruptcy Courts in Applying the "Adequate Information" Standard

The Fifth Circuit decision in this case will disrupt the lower courts' principled interpretation of § 1125 by its holding that determination of what is "adequate information" is "subjective". 844 F.2d at 1157, App. at 27a. Virtually all of the reported decisions by lower courts list *objective* standards and criteria to be followed. *See* pp. 10-12 *supra*.

Critically, however, the Fifth Circuit's holding that valuation of *the most important assets* of the debtors was unnecessary is bad law, providing poor construction of § 1125. Unless this erroneous construction of § 1125 is quickly corrected, bankruptcy courts will be encouraged to circumvent the key to the whole reorganization statute by omitting evaluations of significant assets. Since circuit court review of bankruptcy matters is often prevented by financial limitations and time pressures, this Court should not defer ruling on this crucial point until a conflict develops between circuits.

II. This Case Should be Reviewed Not Only Because the Fifth Circuit Decision Conflicts With This Court's Decision in *Marathon*, But Also Because the Lower Courts Desperately Need Guidance in Construing *Marathon*

In *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), this Court held that to the extent that the Bankruptcy Reform Act granted jurisdiction of "all civil proceedings arising under Title 11", it was unconstitutional, giving Congress over three months to remedy the situation (*id.* at 88), later extending this until December 25, 1982.[3] Congress did not act within the time period prescribed and the Supreme Court refused to grant a further stay of the judgment.[4] Thereafter, the Judicial Conference of the United States proposed an "Emergency Rule" which was adopted as the Local Rule of the Northern District of Texas Concerning Bankruptcy Cases and Proceedings on December 21, 1982. (App. 151a).

The Fifth Circuit, in *In re Braniff Airways*, 700 F.2d 214 (5th Cir.), *cert. denied*, 461 U.S. 944 (1983), has upheld the Emergency Rule, as have other circuits.[5]

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3. *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 459 U.S. 813 (1982).

4. *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 459 U.S. 1094 (1982).

5. *In re Kaiser*, 722 F.2d 1574 (2d Cir. 1983); *Coastal Steel Corp. v. Tilghman Wheelabrator, Ltd.*, 709 F.2d 190 (3d Cir.), *cert. denied*, 464 U.S. 928 (1983); *In re Davis*, 730 F.2d 176 (5th Cir. 1984); *White Motor Corp. v. Citibank, N.A.*, 704 F.2d 254 (6th Cir. 1983); *In re Hansen*, 702 F.2d 728 (8th Cir.), *cert. denied*, 463 U.S. 1208 (1983); *Oklahoma Health Serv. Fed. Credit Union v. Webb*, 726 F.2d 624 (10th Cir. 1984).

This Court's decision in this case, determining whether the bankruptcy court constitutionally exercised jurisdiction over petitioners' state law based contract claims, will provide critical guidance to the lower courts in distinguishing between "core" and "non-core" proceedings. Indeed, as the successor to the Bankruptcy Judge below has written,

> [T]he post-*Marathon* era has developed into *one of the most confusing periods in the history of federal jurisprudence*. The explosive proliferation of lower court opinions following *Marathon* and the Bankruptcy Amendments and Federal Judgeship Act of 1984 . . . attests to the degree of uncertainty and resulting inconsistency among lawyers and judges.

In re Satelco, Inc., 58 B.R. 781, 782 (Bkr. N.D.Tex. 1986) (Emphasis added).

In enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984 which included 28 U.S.C. § 157, Congress' apparent intent was to codify the Emergency Bankruptcy Rule. *See In re Bokum Resources, Corp.*, 49 B.R. 854, 864 (Bkr. D. New Mexico 1985), citing 130 Cong. Rec. H1846, H1487. The Emergency Interim Rule and 28 U.S.C. § 157 are virtually identical in structure and in their analysis of the distinction between so-called "core" and "non-core" cases.[6]

Ever since the passage of 28 U.S.C. § 157, there has been widespread confusion and difference of opinion among the lower courts in construing the statute. As

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6. While the terminology varies somewhat as between the interim rule and the statute, both attempt to distinguish between types of disputes over which the bankruptcy court has jurisdiction to enter final orders (so-called "core" proceedings), and those cases which, absent consent, must be tried by an Article III court (so-called "related" or "non-core" proceedings).

explained in *In re Counts,* 54 B.R. 730, 734 (Bkr. D. Colo. 1985), and *In re Satelco, Inc.,* 58 B.R. at 783, some courts, believing that the statute cures the constitutional defects found in *Marathon,* construe it broadly to include all types of proceedings which come within the literal meaning of Section 157(b)(2).[7] Other courts, taking the view that the statute does not cure the constitutional defects explained in *Marathon,* hold that the term "core proceeding" must be interpreted narrowly, using the *Marathon* decision as a guideline.[8]

The expansive reading of 28 U.S.C. § 157 opens the door for an unconstitutional application of the statute, as succinctly explained by the court in *In re Republic*

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7. Cases in which the expansive view is enunciated include *In re Arnold Print Works, Inc.,* 815 F.2d 165 (1st Cir. 1987); *In re Lion Capital Group,* 46 B.R. 850 (Bkr. S.D.N.Y. 1985); *In re Lombard-Wall, Inc.,* 46 B.R. 365 (S.D.N.Y. 1985); *Macon Prestressed Concrete Co. v. Duke,* 46 B.R. 727 (D. Ga. 1985); and *In re Marketing Resources Intern Corp.,* 43 B.R. 71 (Bkr. E.D. Pa. 1984). *In re All American of Ashburn, Inc.,* 49 B.R. 926 (Bkr. N.S. Ga. 1985); *In re Delorean Motor Company,* 49 B.R. 900 (Bkr. E.D. Mich. 1985); *In re Shell Materials, Inc.,* 13 B.C.D. 185 (Bkr. M.D. Fla. 1985); *In re Franklin Computer Corporation,* 50 B.R. 620 (Bkr. E.D. Pa. 1985); *In re Harry C. Partridge, Jr. & Sons, Inc.,* 48 B.R. 1006 (S.D.N.Y. 1985); *In re Ram Construction Company, Inc.,* 49 B.R. 363 (W.D. Pa. 1985); *In re Bucyrus Grain Company, Inc.,* 56 B.R. 204 (Bkr. D. Ks. 1986).

8. Cases following this restrictive analysis include *In re Pierce,* 44 B.R. 601 (D. Colo. 1984); *In re Bokum Resources Corp., supra; In re Illinois-California Express, Inc.,* 50 B.R. 232 (Bkr. D. Colo. 1985); *Mohawk Industries v. Robinson Industries,* 46 B.R. 464 (D. Mass. 1985); *In re Atlas Automation, Inc.,* 42 B.R. 246 (Bkr. E.D. Mich. 1984); *In re Morse Electric Co., Inc.,* 47 B.R. 234 (Bkr. N.D. Ind. 1985); *In re Alexander,* 49 B.R. 733 (Bkr. D. N.D. 1985); *In re Nanodata Computer Corporation,* 52 B.R. 334 (Bkr. W.D. N.Y. 1985), *aff'd,* 74 B.R. 766 (W.D. N.Y. 1987); *In re Zweygardt,* 52 B.R. 229 (Bkr. D. Colo. 1985); *In re Yagow,* 53 B.R. 737 (Bkr. D. N.D. 1985); *In re Crabtree,* 55 B.R. 130 (Bkr. E.D. Tenn. 1985); *In re Smith-Douglass, Inc.,* 43 B.R. 616 (Bkr. E.D. N.C. 1984).

Readers Service, Inc., 81 B.R. 422, 427 (Bkr. S.D. Tex. 1987):

> Often a proceeding, cast in the language of a core proceeding, merely shrouds state law actions under the guise of a bankruptcy issue. A typical example is an adversary proceeding commenced as an action for turnover of property under 11 U.S.C. § 542. An action for turnover of property is a core proceeding under 28 U.S.C. § 157(b)(2)(E). Frequently, a breach of contract claim identical to the cause of action at issue in the *Marathon* [sic] is presented as a core proceeding as inducement for the court to exercise power over the proceeding.

In fact, the court in *In Re Partridge*, 48 B.R. 1006, (Bkr. S.D.N.Y. 1985) assumed jurisdiction on this basis. There, the court concluded that the debtors' contract action against a creditor could be construed as an action for turnover of estate property, and therefore, the contract claim was a core proceeding under 28 U.S.C. § 157 (b)(2)(E). *Id.* at 1010. Such a holding flies in the face of this Court's ruling in *Marathon* that state law based contract claims are non-core proceedings.[9]

In *In re Marketing Resources International*, 43 B.R. 71 (Bkr. E.D. Pa. 1984), the court found the debtor's claim against a creditor for tortious interference with contractual relations to be a core proceeding, on the basis that since the creditor had previously filed a proof of claim, the debtor's complaint could thereby be construed as a "counterclaim", and thus a core proceeding, under 28 U.S.C. § 157(b)(2)(C). As was pointed out in *Bokum*, 49 B.R. at 863, such a mechanical application

9. For a well-reasoned criticism of the holding in *Partridge*, see *In re Satelco, Inc.*, 58 B.R. at 786.

of the statute results in "a return to the much-maligned jurisdiction by ambush which prevailed prior to 1978."

Cases such as *Partridge* and *Marketing Resources,* which interpret the statute broadly, are clearly at odds with *Marathon,* which, at a minimum, held that "Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to appellate review". *Thomas v. Union Carbide Agricultural Products Co.,* 473 U.S. 568, 584 (1985).

"Jurisdiction by ambush" accurately describes the bankruptcy court's actions below. By adjudicating petitioners' contract claims, over petitioners' objections, the bankruptcy court extended its jurisdiction to a lawsuit over which it clearly would not have had jurisdiction, but for the fact that the defendant in the contract action was seeking approval of a petition for reorganization. See *Marathon,* 458 U.S. at 90 (Justice Rehnquist, concurring). If, rather than applying the emergency interim rule mechanically,[10] the bankruptcy court below had tempered its reading of the rule in light of *Marathon,* it would have correctly concluded that the state law issues were non-core proceedings, the ultimate resolution of which had to rest with an Article III court. See *Bokum,* 49 B.R. at 866.

To allow the bankruptcy court below to adjudicate petitioners' state law contract claims solely on the basis that a creditor has proposed to dismiss those claims as part of a plan of reorganization, is to beg the underlying

10. It is fundamental that statutes must be construed, if fairly possible, to avoid doubts as to constitutionality. *St. Martin Evangelical Lutheran v. South Dakota,* 451 U.S. 772, 780 (1981).

question and recite a tautology. As was pointed out in *In re Satelco, Inc.*, 58 B.R. at 786, in rejecting the holding of *Partridge*,

> Such an approach is, however, fundamentally flawed. It would turn mere allegation into fact; by asserting that the money attributable to an account receiveable is property of the estate, a debtor could, under the foregoing authorities, establish the constructive possession necessary for the bankruptcy court to exercise jurisdiction.

58 B.R. at 786.

Moreover, *Satelco* hints at another potentially severe problem with this Court's toleration of the expansive view of the statute—the problem of forum shopping. Under the expansive view of the statute, a party can transform an otherwise non-core proceeding into a core proceeding by the use of labelling and procedural gamesmanship in the bankruptcy court. Respondent has engaged in precisely this kind of conduct below, by taking petitioners' non-core, state law related, contract claims, and incorporating their proposed dismissal into respondent's proposed plan of reorganization.

For all of these reasons, the lower courts are sorely in need of this Court's guidance as to the proper interpretation of its decision in *Marathon*, which will directly affect construction of both the Emergency Interim Rule and 28 U.S.C. § 157, particularly in light of the "maelstrom of conflicting decisions" surrounding this issue. See *In re Satelco, Inc.*, 58 B.R. at 783. Since bankruptcy courts are daily confronted with decisions concerning these matters, and the decisions they make affect fundamental constitutional rights, the Fifth Circuit decision should be reviewed now so that the bankruptcy courts will have guidelines in making their decisions.

III. The Fifth Circuit Decision Should Be Reviewed Because It Incorrectly Applies the Rule Against *Ex Parte* Contacts, and Requires this Court's Exercise of its Supervisory Powers to Regulate Such Conduct

At the conclusion of the evidence, the Bankruptcy Judge announced oral findings of fact, (App. 92a), in which he made numerous findings supporting petitioners' claims of Lockheed's breaches of contract. (*Id.* at 95a-101a). On March 20, 1984, he signed written findings of fact and conclusions of law (App. 119a), which were radically different and omitted the findings of Lockheed's breach.

At the hearing on petitioners' motion to amend the findings, the Bankruptcy Judge stated, and counsel for Lockheed admitted, that there were four drafts of the Findings of Fact and Conclusions of Law submitted to the judge by Lockheed's counsel, and not one of the four drafts was sent to counsel for appellants (Hearing on Motion to Amend the Findings of Fact and Conclusions of Law on April 2, 1984 at 40-57). It was only when a final draft, satisfactory to both counsel for Lockheed and the Bankruptcy Judge, had been prepared and signed, that counsel for petitioners was permitted to receive a copy. Such conduct was in direct violation of Rule 9003 of the Bankruptcy Rules, DR 7-110(B) of the Texas Code of Professional Responsibility and Canon 3A(4) of the Texas Code of Judicial Conduct.

Ex parte discussions with a judge are simply not permitted. The Advisory Committee Note to Bankruptcy Rule 9003 states that "this regulation of the conduct of parties in interest and their representative is designed to

insure that the bankruptcy system operates fairly and that no appearance of unfairness is created." This Advisory Committee Note refers to H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 95 *et seq.* (1977) which states

> [T]here is an unusually close relationship between the bankruptcy judges and the bankruptcy bar, especially the debtors' and trustees' bar. They are in frequent contact with the judge as a result of the necessity for the judge's review of the administrative actions of the trustee or debtor-in-possession. Debtors' attorneys make frequent appearances at the same court representing numerous different debtors. All of these contacts and relationships have led to a feeling among non-bankruptcy practitioners that there is a "bankruptcy ring" that has an inside track on all the bankruptcy matters, including the judges' favoritism.

The reasoning of the Fifth Circuit in permitting the extensive series of *ex parte* discussions in this case has created a standard which is meaningless, and which effectively invites *ex parte* communications. The Fifth Circuit concluded that the matters were no longer "pending" before the Bankruptcy Judge, because he "had already verbally ruled that he was confirming the plan". 844 F.2d at 1164, App. at 44a.

This standard is meaningless because the matter was obviously still "pending" before the Bankruptcy Judge, in that he still retained plenary jurisdiction over all matters relating to the plan of reorganization, and could have reopened the evidence or changed his ruling. Indeed, the Fifth Circuit admits as much when it notes that oral findings are always subject to revision. 844 F.2d at 1164, App. at 45a. Furthermore, the matter was still "pending"

because, as all practitioners know, the exact language of written findings of fact, or indeed of orders or judgments, can often make all the difference in the world on appeal as to affirmance or reversal.

The implications of the Fifth Circuit's holding are disturbing, given the frequent nature of pretrial matters submitted to courts for determination. If the Fifth Circuit's analysis is correct, once an attorney wins any type of pretrial motion, he will be free to engage in extensive discussions with the court concerning that matter, since it is no longer "pending", in the process potentially creating substantial further prejudice against the opposing party. The correct standard which the Fifth Circuit should have applied, and which this Court should emphatically pronounce, is set forth in *In re Wisconsin Steel,* 48 B.R. 753 (N.D. Ill. 1985), in which the district court strongly criticized the bankruptcy court and counsel for the one-time *ex parte* submission of an opinion to the court by counsel.

The decision of the Eleventh Circuit in *In re Colony Square,* 819 F.2d 272 (11th Cir. 1987), which closely parallels the decision of the Fifth Circuit in this case, must likewise be disapproved. Unlike the complaining party in *Colony Square,* who had apparently known for some time of the offending conduct, but not objected until after the decision in *Wisconsin Steel* was announced, see 60 B.R. 1003, 1023, the petitioners here made objections to the written findings of fact immediately after they were received and held a hearing shortly thereafter, all before the decision in *Wisconsin Steel* was announced.

Finally, the reliance by the Fifth Circuit upon the fact that petitioners were allowed the opportunity to make

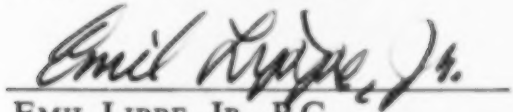
"vigorous" presentation of objections to the written findings, 844 F.2d at 1164, App. at 45a, is totally meaningless. Indeed, the Bankruptcy Judge announced at the beginning of the hearing that since he had gone through four drafts, it was not likely that he was going to make any changes. Such a frank admission by the Bankruptcy Judge below is clearly the likely result whenever counsel attempts, after the fact, to challenge the combined work product of opposing counsel and the judge arrived at behind closed doors.

For these reasons, the outrageous conduct of Lockheed's counsel must be proscribed, and the Fifth Circuit's decision on this point must be reversed, in order to avoid complete circumvention of the rule prohibiting *ex parte* communications. This is a matter of overarching importance to the administration of the federal judiciary, which transcends the bounds of the bankruptcy courts, and which threatens the very appearance of fairness in the federal judicial system. For this reason, this Court should exercise its supervisory power, and reverse the decision of the Fifth Circuit.

CONCLUSION

For the reasons stated above, the petition for certiorari should be granted. Upon final consideration, the written findings of fact should be stricken, and the order of the Bankruptcy Court either reversed, with the matter remanded to the Bankruptcy Court for further action, or, in the alternative, remanded to the District Court for a *de novo* determination of the facts consistent with 28 U.S.C. § 157, and this Court's ruling in *Marathon,* and petitioners should be awarded their costs and general relief.

Respectfully submitted,



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